Statement of James W. Sauber, Chairman of the Employee Thrift Advisory Council to the House Sub-Committee on the Federal Workforce and Agency Organization regarding "Real Estate Investment Trusts (REITS): Can They Improve the Thrift Savings Plan?"

April 19, 2005

Thank you to Chairman Jon Porter and to the members of the Sub-Committee for this opportunity to submit a statement for the record of this important hearing on Real Estate Investment Trusts (REITs) and the Thrift Savings Plan (TSP). I regret very much that I could not accept your invitation to testify in person – a prior commitment will prevent me from being in Washington on the day of the hearing.

My name is James Sauber. I am the Director of Research for the National Association of Letter Carriers (NALC), a union which represents 310,000 active and retired letter carriers employed by or retired from the United States Postal Service. At present I also serve as the Chairman of the Employee Thrift Advisory Council (ETAC), the body established by the Federal Employees Retirement System Act (FERSA) of 1986 to give a voice to federal and postal employees in the operations of the TSP. I have been actively involved with the Council since its creation in 1987, first as an aide to its first chairman, former NALC President Vincent Sombrotto, and then as a member of the Council and now as its chairman.

ETAC advises the Federal Retirement Thrift Investment Board of the views and concerns of TSP participants through regularly scheduled meetings with the Executive Director of the Board. ETAC is made up of 15 individuals who are nominated by employee organizations identified in the FERSA statute that represent the federal workforce in all its diversity, from

federal and postal employees and federal managers to senior executives and federal retirees. A list of ETAC members is appended to this statement.

The Thrift Savings Plan is a vital component of federal and postal employees' overall compensation package. Participation in the plan is crucial to the retirement security of federal employees, who also earn a modest defined benefit annuity and Social Security benefits. Thanks to a sound design that utilizes index funds to minimize both transaction costs and political interference with investment decisions, the TSP has proven to be very popular with federal and postal employees. Many agencies report TSP participation rates in excess of 85% among FERS-covered employees. My union, the NALC, is proud to report that 95% of letter carriers who participate in the TSP contribute at least five percent of their salaries. Greater than half contribute 10 percent or more.

I emphasize the popularity of the TSP at the outset to underline my primary advice to you: please exercise caution when contemplating major changes in this very successful benefit program. I believe the TSP to be one of the government's best tools to attract and retain excellent workers to serve the country in public service. With that introduction, I am happy to address the central question posed by this hearing: Can Real Estate Investment Trusts improve the Thrift Savings Plan?

I should start by making it clear that the Employee Thrift Advisory Council has not taken a position on this question and that the views expressed in this statement are mine alone, not those of the Council. Indeed, the Council has not yet discussed the recently proposed "Real Estate Investment for Thrift Savings Act." We plan to do so at our next scheduled meeting on May 4, 2005. At this point I think it is safe to say that, like many members of this Sub-Committee, many members of the ETAC are interested in gathering as much information as possible before making a judgment. That's why we welcome this hearing. We hope to learn more about the pros and cons of a REIT option.

Of course, I am aware that the National Association of Real Estate Investment Trusts has advocated a REIT option in the TSP. In fact, last year my union invited the NAREIT to make a presentation on the issue for interested officers and staff. And earlier this year, I arranged for a similar presentation for a number of other federal and postal employee organizations that expressed interest in learning more about REITs. Many members of ETAC have therefore heard the case for adding a REIT fund.

In the May meeting of ETAC, we want to discuss the Federal Thrift Investment Board's views on the REIT fund option. We are aware that the Board has expressed some reluctance to go forward with a REIT fund at

this time. My colleagues and I are interested in exploring the Board's reasons for this stance.

As chairman of ETAC, I see my role as facilitating an informed discussion of matters affecting the TSP. That is how I will approach the REIT issue. In so doing, I plan to make a number of suggestions on how I think the Board and the members of ETAC should handle this issue. In particular, I plan to make two general recommendations and pose three specific questions about the REIT fund option that I believe must be answered before a decision can be made on the merits.

First, as a general matter, I think it is important for policymakers such as the members of this Sub-Committee and members of the Federal Retirement Thrift Investment Board to consider the full range of new fund options before coming to any conclusion about any specific fund like the REIT index fund. Although the existing TSP funds clearly provide a comprehensive cross section of the financial marketplace (including REITS), there are sure to be other possibilities besides a dedicated REIT fund. I am particularly interested in considering inflation-indexed bonds, for example. Before deciding what kind of fund to add to the TSP, we should first consider all the possibilities.

A second general concern that I will raise with the Advisory Council has to do with the possible downside of adding additional funds. At a time when the FRTIB is preparing to add lifecycle funds (options comprised of varying proportions of the existing five funds), do we risk sacrificing one of the TSP's greatest virtues by adding yet another fund: namely, its simplicity.

While there is nothing magical about the number five (or six, after the addition of the L Fund set of options), placing some limit on the number of funds makes sense. Having a simple, understandable set of options for the TSP has clearly helped boost participation rates. Research concerning private sector 401(k) plans has shown that too many choices can cause participation rates to flag and that a common complaint among participants about their 401(k)s is that the plans offer too many investment options. Quite frankly, workers get confused when faced with too many investment choices. This confusion, and the absence of automatic enrollment in most private sector plans (similar to that which exists with the TSP), may explain why participation rates in 401(k)s are generally much lower than that observed for the TSP. Too many funds can also raise administrative costs beyond the added benefit of additional choices.

If adding funds could reduce participation rates and raise costs, it might be worthwhile to ask ourselves: What is the optimum number of investment options for the TSP? My own sense is we might add one or two additional

funds before we reach a point of diminishing returns. Others might argue that we have already passed that point or that we can safely add even more. Whatever the case may be, I think it is important for us to set an upper limit on the number of funds <u>before</u> we decide whether to use one of the limited "slots" available to add a REIT fund or any other specific fund to the TSP.

Beyond, these general points, I also plan to raise three specific sets of questions about the proposed REIT fund with my colleagues on the Council:

- **Would adding a REIT fund represent a departure from the basic plan design envisioned by the FERSA act? Namely, would a fund dedicated to a fairly narrow sector of the economy – commercial real estate – contravene the spirit of FERSA, which limited the TSP's private sector investments to broad index funds that cut across all the major sectors of the economy? If so, would it set a dangerous precedent? Would other sector interests line up at Congress' door asking to be given equal treatment?**

- **How would adding a REIT Fund -- the R Fund – affect the administrative costs of the overall TSP? Although we might expect the TSP to obtain management services at a lower cost than that observed for smaller, private sector plans (given its superior track**

record with the existing index funds), how would the fees charged to run the R Fund compare to those charged to run the existing funds?

- **And is the REIT market large enough and liquid enough to handle the kind of volume of trading that might potentially arise through a large plan like the TSP? A thinly traded market could raise costs considerably.**

I suspect that these are the kind of questions that are likely to be raised by the Sub-Committee in today's hearing and in the deliberations that follow. I look forward to having these and other questions answered.

At this point, and speaking only for myself, I must say that I am somewhat skeptical about the wisdom of adding a REIT fund to the TSP. I remain so for one primary reason: I am not aware of any significant demand for this option by members of the federal workforce. For example, in my own union, I have conducted training seminars on the TSP at our national conventions for years and have never had a question about adding real estate investments to the TSP. The same was not the case with the international and small cap investment options, which the Board eventually added to the TSP in the form of the I and S Funds.

I will, of course, keep an open mind about the proposed legislation as will, I am sure, my colleagues on the Employee Thrift Advisory Council. We will fully discuss the Real Estate Investment for Thrift Savings Act at our May 4 meeting. I can assure you that if the Advisory Council reaches a consensus on the bill, we will share our views with you and the Sub-Committee promptly. Of course, it is possible that some of our organizations will support the proposal and others may not – in which case, a common ETAC position will not be possible. Regardless, it is my hope that the Employee Thrift Advisory Council can play a constructive role in the debate over this legislation.

Thank you again for the opportunity to participate in this hearing.